Chapter One

The Budget Outlook

The outlook for the federal budget over the next decade continues to be bright. Assuming that current tax and spending policies are maintained, the Congressional Budget Office (CBO) projects that mounting federal revenues will continue to outstrip spending and produce growing budget surpluses for the next 10 years. The update of CBO's budget outlook that this chapter describes continues a trend, since 1997, of steady and sometimes dramatic improvement, reflecting the continuing impact of strong economic growth over the past few years.

Although the economy has slowed in recent months—holding down the rate of growth in estimated surpluses in the short run—CBO expects economic growth to rebound later this year and, in the absence of substantial policy changes, to continue to produce large budget surpluses for the next decade. Nevertheless, over the longer term, budgetary pressures linked to the aging and retirement of the baby-boom generation threaten a return to high deficits and unsustainable levels of federal debt.[1]

The favorable budget outlook for the next 10 years builds on a period of budget surpluses that is already historic. Fiscal year 2000 ended with a total surplus (that is, including the off-budget transactions of Social Security and the Postal Service) of $236 billion.[2] CBO estimates that 2001 will conclude with a total surplus of $281 billion (see Table 1-1). That surplus, at 2.7 percent of gross domestic product (GDP), would be the largest relative to the size of the economy since 1948. If it is realized, 2001 will mark the first time in at least a century that rising surpluses have been recorded for four consecutive years. Over that four-year span, total surpluses could sum to more than $700 billion, leading to a roughly equivalent reduction in federal debt held by the public. When combined with recent strong economic growth, that drop would also lead to a significant decrease in federal debt as a percentage of the economy. CBO estimates that federal debt will fall to around 30 percent of GDP in 2001, a substantial decline from the nearly 50 percent of GDP it reached in the mid-1990s.

Notably, the total surpluses for 2000 and 2001 also include growing on-budget surpluses ($86 billion and $125 billion, respectively)—the first large on-budget amounts since the recent string of surpluses began in 1998. Those on-budget amounts, and later projections of even greater sums, are significant for the budget policy debate. Many lawmakers have declared their intent to preserve all off-budget surpluses, which consist principally of those generated by the Social Security trust funds, to reduce outstanding debt held by the public. For those lawmakers,

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1. See Congressional Budget Office, *The Long-Term Budget Outlook* (October 2000).

2. The Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and the Postal Service fund were placed off-budget by laws enacted in 1985 and 1989, respectively. Off-budget federal entities are owned and controlled by the government, but their transactions are excluded from the budget totals by law; their receipts and outlays are excluded from the totals in the President's budget and from the Congressional budget resolution and are not counted for budget enforcement purposes. However, supporting budget documents and other analyses often combine off-budget and on-budget amounts into a consolidated, or unified, presentation to give a complete picture of total government revenues, spending, surpluses, and deficits.

Table 1-1.
The Budget Outlook Under Current Policies (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2011
On-Budget Surplus	86	125	142	171	196	212	267	316	359	417	484	558	3,122
Off-Budget Surplus[a]	150	156	171	188	201	221	238	257	276	294	312	331	2,488
Total Surplus	236	281	313	359	397	433	505	573	635	710	796	889	5,610
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818	n.a.
Balance of Uncommitted Funds[b]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28	466	1,003	1,608	2,338	3,164	n.a.
Net Indebtedness[c]	3,410	3,148	2,848	2,509	2,131	1,714	1,223	662	36	-669	-1,460	-2,346	n.a.
Memorandum:													
Social Security Surplus	152	157	172	188	202	221	238	257	276	294	312	331	2,490
Total Surplus as a Percentage of GDP	2.4	2.7	2.9	3.1	3.3	3.4	3.8	4.1	4.3	4.6	4.9	5.3	n.a.
Debt Held by the Public as a Percentage of GDP	34.7	30.5	26.2	21.9	17.7	13.5	9.4	8.1	7.1	6.1	5.5	4.8	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

b. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

c. Negative net indebtedness means that the balance of uncommitted funds exceeds the remaining debt held by the public.

only on-budget surpluses would be available for new spending or revenue policies, and those projected surpluses establish the limits for legislative action on the budget.

From 2002 through 2011, CBO projects rising surpluses under current policies. Total budget surpluses, by CBO's estimates, would grow from about 3 percent to more than 5 percent of GDP, and on-budget surpluses would climb from over 1 percent to more than 3 percent (see Table 1-2 on page 4).[3] Under current policies, total surpluses would accumulate to an estimated $2 trillion over the next five years and $5.6 trillion over the coming decade, and would be sufficient by 2006 to pay off all publicly held debt that is available for redemption. Within those totals, on-budget surpluses would climb to nearly $1 trillion over the next five years and about $3.1 trillion over the 2002-2011 period; five-year and 10-year totals for off-budget surpluses would be about $1 trillion and about $2.5 trillion, respectively. Off-budget surpluses alone would be sufficient to eliminate the available debt by the end of the 10-year period.

CBO's estimates of rising surpluses continue the recent trend of improving bottom lines in its baseline budget projections. The budget outlook in this report is more favorable than the one CBO issued in its July 2000 report, *The Budget and Economic Outlook: An Update*. Estimates of the total surplus and the on-budget surplus for 2001 have both improved:

3. Those estimates assume that discretionary spending grows at projected rates of inflation over the 10-year period.

the total surplus ($281 billion) is about $13 billion higher than CBO's estimate in July, and the on-budget surplus ($125 billion) has increased by about $23 billion. (CBO's current estimate of the off-budget surplus for 2001 is lower by about $9 billion compared with July's.)

Last summer, CBO projected a cumulative total surplus of $4.6 trillion for the 2001-2010 period. In this report, which discusses the outlook for 2002 through 2011, projected surpluses accumulate to $5.6 trillion. Of that $1 trillion increase, about $600 billion is simply due to shifting the 10-year budget horizon forward one year and dropping 2001 from the total. The remaining $441 billion is the net effect of CBO's higher baseline projections of total revenues and outlays since July.

As noted earlier, the projected strength in the economy over the next decade, which CBO estimates will boost revenues, is mainly responsible for the outlook's improvement since July. CBO's projections of revenues over the 2001-2010 period are now $919 billion higher than they were in the summer. That hike can be attributed to the effects of a stronger economy over the period ($802 billion) and adjustments for certain technical factors, such as higher capital gains realizations, over the next few years ($153 billion). Tax cuts enacted near the end of the 106th Congress are projected to reduce revenues by about $37 billion through 2010. CBO expects that the overall rate of growth in tax receipts will slow from its rapid pace of recent years; nevertheless, it will remain strong over the 10-year budget horizon. (Chapter 3 discusses CBO's outlook for revenues.)

About half of the projected boost in revenues is offset by higher anticipated spending over the period that curbs the overall rise in total surpluses. Under current policies, CBO expects a net increase in total spending of $478 billion relative to the July projections. Legislation enacted since then pushes up outlays by $561 billion, with about two-thirds of that legislated increase—$368 billion—going toward discretionary spending (which is provided and controlled in annual appropriation acts) and the rest—$193 billion—going toward mandatory spending (which is controlled by laws other than appropriation acts).[4] Of the estimated change in mandatory spending, about two-thirds (or $127 billion) is for higher net interest costs associated with the increase in total spending caused by new legislation. Changes in CBO's economic and technical assumptions reduce projected net spending by $83 billion below the July estimates.

The favorable outlook for the next several years, however, is subject to considerable uncertainty. Final annual outcomes for the federal budget will differ, perhaps significantly, from CBO's projections, which show spending and revenues under current policies. Those policies will almost certainly change, and the changes could have sizable budgetary effects. For instance, the Presidential and Congressional election campaigns in 2000 included major debates over how best to use burgeoning on-budget surpluses. Those debates may presage major changes in federal spending or tax policies in the coming years that are not reflected in CBO's budget outlook.

An additional source of uncertainty is the accuracy of the economic and technical assumptions that CBO uses in making its baseline budget projections. (Chapter 5 describes the uncertainties that underlie such assumptions.) In recent years, economic growth has surpassed expectations, fueling projections of higher revenues and bigger surpluses. A downturn in the economy, depending on its severity and duration, could greatly diminish or even eliminate surpluses over the next few years.

The uncertainty inherent in CBO's projections becomes more significant when considering the budgetary challenges that loom just beyond the current 10-year budget horizon. Toward the end of that period, the post-World War II baby-boom generation will begin leaving the workforce. The baby boomers' retirement and aging will lead to increasing pressure on spending for federal programs for the elderly. The projected surpluses, if realized, would help the country begin to address those longer-term budgetary stresses. Budget surpluses reduce the government's need to borrow, thereby increasing national saving.

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4. Because appropriations for years after 2001 are not yet in place, CBO's projections of discretionary spending extrapolate from the levels appropriated for 2001.

Table 1-2.
CBO's Baseline Budget Projections (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
In Billions of Dollars												
Revenues												
Individual income	1,004	1,076	1,125	1,176	1,230	1,289	1,354	1,424	1,500	1,583	1,675	1,774
Corporate income	207	215	217	226	236	246	255	264	276	289	303	319
Social insurance	653	686	725	762	797	840	879	921	963	1,010	1,059	1,110
Other	161	158	169	179	190	194	200	207	216	225	233	244
Total	2,025	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447
On-budget	1,545	1,630	1,703	1,782	1,864	1,950	2,040	2,136	2,243	2,360	2,489	2,628
Off-budget	481	504	532	561	589	620	649	680	712	746	782	819
Outlays												
Discretionary spending	617	646	682	710	730	750	766	782	804	824	845	866
Mandatory spending	1,030	1,089	1,157	1,219	1,296	1,378	1,441	1,520	1,614	1,713	1,820	1,934
Offsetting receipts	-81	-87	-95	-108	-111	-107	-113	-119	-125	-131	-139	-147
Net interest	223	205	179	163	142	116	90	72	65	58	53	51
Proceeds earned on the balance of uncommitted funds[a]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-1	-12	-38	-68	-104	-146
Total	1,789	1,853	1,923	1,984	2,056	2,137	2,184	2,243	2,320	2,396	2,475	2,558
On-budget	1,458	1,506	1,561	1,611	1,669	1,738	1,773	1,820	1,884	1,943	2,005	2,070
Off-budget	331	348	361	373	388	399	411	423	437	453	470	489
Surplus	236	281	313	359	397	433	505	573	635	710	796	889
On-budget	86	125	142	171	196	212	267	316	359	417	484	558
Off-budget	150	156	171	188	201	221	238	257	276	294	312	331
Memorandum:												
Gross Domestic Product	9,828	10,319	10,880	11,477	12,059	12,656	13,279	13,932	14,619	15,338	16,109	16,922

(Continued)

Saving promotes economic growth, and a strong and growing economy will make future obligations, both public and private, easier to meet.

But even substantial surpluses over the next several years cannot eliminate the budgetary tensions that coming demographic changes and rising health care costs will bring. The nation will still have to find a way to deal with those long-term costs. Near-term surpluses do not change the underlying dynamic driving the long-term budget outlook. Over the next 40 years, the number of workers will increase by only about 18 percent while the number of Social Security and Medicare beneficiaries will almost double. With continuing boosts in life expectancy, those beneficiaries will also be older, causing a near-tripling in the population over age 85 by 2040. Further, those trends will increase the cost of long-term care, over half of which is financed by Medicaid and Medicare.[5] In its most recent report on the long-term budget outlook, CBO assumed that Medicare costs would continue to grow faster than the economy (by about 1 percent annually over the long term).[6] That report projected that the combined effect of demographic developments and growth in medical costs would push spending on Medicare, Medicaid, and Social Security from 7.5 percent of GDP in 1999 to 16.7

5. See Congressional Budget Office, *Projections of Expenditures for Long-Term Care Services for the Elderly* (March 1999), pp. 1 and 5–6.

6. See Congressional Budget Office, *The Long-Term Budget Outlook*, pp. 3-4.

Table 1-2.
Continued

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
As a Percentage of GDP												
Revenues												
Individual income	10.2	10.4	10.3	10.2	10.2	10.2	10.2	10.2	10.3	10.3	10.4	10.5
Corporate income	2.1	2.1	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Social insurance	6.6	6.6	6.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Other	1.6	1.5	1.6	1.6	1.6	1.5	1.5	1.5	1.5	1.5	1.4	1.4
Total	20.6	20.7	20.5	20.4	20.3	20.3	20.2	20.2	20.2	20.3	20.3	20.4
On-budget	15.7	15.8	15.7	15.5	15.5	15.4	15.4	15.3	15.3	15.4	15.5	15.5
Off-budget	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.8
Outlays												
Discretionary spending	6.3	6.3	6.3	6.2	6.0	5.9	5.8	5.6	5.5	5.4	5.2	5.1
Mandatory spending	10.5	10.5	10.6	10.6	10.7	10.9	10.8	10.9	11.0	11.2	11.3	11.4
Offsetting receipts	-0.8	-0.8	-0.9	-0.9	-0.9	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9
Net interest	2.3	2.0	1.6	1.4	1.2	0.9	0.7	0.5	0.4	0.4	0.3	0.3
Proceeds earned on the balance of uncommitted funds[a]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	*	-0.1	-0.3	-0.4	-0.6	-0.9
Total	18.2	18.0	17.7	17.3	17.1	16.9	16.4	16.1	15.9	15.6	15.4	15.1
On-budget	14.8	14.6	14.4	14.0	13.8	13.7	13.4	13.1	12.9	12.7	12.4	12.2
Off-budget	3.4	3.4	3.3	3.3	3.2	3.2	3.1	3.0	3.0	3.0	2.9	2.9
Surplus	2.4	2.7	2.9	3.1	3.3	3.4	3.8	4.1	4.3	4.6	4.9	5.3
On-budget	0.9	1.2	1.3	1.5	1.6	1.7	2.0	2.3	2.5	2.7	3.0	3.3
Off-budget	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8	1.9	1.9	1.9	2.0

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = between -0.5 percent and zero.

a. "Uncommitted funds" is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

percent in 2040. If federal policies did not change in response to those trends, high deficits would return and eventually drive federal debt to unsustainable levels.

The Baseline Concept

The baseline serves as a neutral benchmark that the Congress can use to measure the effects of proposed changes in spending and revenue policies. It is constructed following rules that are set forth in law, mainly in the Balanced Budget and Emergency Deficit Control Act of 1985 (the Deficit Control Act) and the Congressional Budget Act of 1974. Those laws generally instruct CBO (and the Administration's Office of Management and Budget) to project federal spending and revenues by assuming that current policies remain the same.

For revenues and mandatory spending, section 257(b) of the Deficit Control Act requires baseline projections to assume that current laws continue without change. In most cases, the laws governing revenues and direct spending are permanent, and the projections incorporate the effects of anticipated

Box 1-1.
A Freeze in Discretionary Spending

The Balanced Budget and Emergency Deficit Control Act of 1985 sets the baseline for discretionary spending as the levels appropriated for the current year adjusted for inflation and certain other specified factors. But some lawmakers view a freeze in discretionary appropriations at the current year's levels as the most logical starting point for considering future appropriations. And from 1991 through 1996, largely because of the decline in defense spending following the end of the Cold War, total discretionary outlays were held at roughly a freeze level. Since 1998, however, discretionary spending has grown relatively rapidly—at a rate that has outpaced inflation over that time. Freezing appropriations for the next 10 years would reduce discretionary spending in 2011 by about 25 percent from its level adjusted for inflation—a cut in resources that seems unrealistic in view of the recent rates of growth.

Nonetheless, if total discretionary spending was frozen at the level enacted for 2001, surpluses throughout the 2002-2011 period would grow even larger than CBO's baseline suggests. Under that scenario, total surpluses (including the off-budget balances of the Social Security trust funds and the Postal Service fund) would reach nearly 7 percent of gross domestic product (GDP), and on-budget surpluses almost 5 percent, by 2011.

The Budget Outlook Assuming That Discretionary Spending Is Frozen at the Level Enacted for 2001 (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2011
On-Budget Surplus	86	125	156	202	245	284	363	437	507	593	692	800	4,279
Off-Budget Surplus	150	156	171	188	201	222	239	257	277	295	313	332	2,495
Total Surplus	236	281	327	390	446	506	602	694	784	888	1,005	1,132	6,774
Total Surplus as a Percentage of GDP	2.4	2.7	3.0	3.4	3.7	4.0	4.5	5.0	5.4	5.8	6.2	6.7	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

changes in the economy, demographics, and other relevant factors to which those laws are linked.[7]

In the case of discretionary spending, which is provided and controlled by annual appropriation acts, section 257(c) of the Deficit Control Act states that projections of discretionary budget authority shall be adjusted after the current year to reflect inflation—using specified indexes—and a limited number of other factors (such as the costs of renewing certain expiring housing contracts and of annualizing adjustments to federal pay). Accordingly, CBO's baseline extrapolates discretionary spending from its current levels, adjusting for projected rates of inflation and other specified factors over the next 10 years.

Last year, CBO presented two other benchmarks for discretionary spending—a freeze level and the statutory limits on discretionary spending. Lawmakers sometimes use a freeze in appropriations—or the current year's amounts without adjustment for inflation—to gauge the impact of proposed levels of discretionary spending for the upcoming fiscal year. However, recent trends in appropriations probably

7. Section 257(b) of the Deficit Control Act also specifies that expiring spending programs are assumed to continue if they have current year outlays greater than $50 million and were established on or before the date of enactment of the Balanced Budget Act of 1997 (BBA). Programs established after enactment of the BBA are not automatically continued in the baseline. Expiring excise taxes dedicated to a trust fund are extended at current rates. However, the section does not provide for extending other expiring tax provisions, including those that have been routinely extended in the past.

make it unreasonable to assume a freeze in the baseline over the next 10 years (see Box 1-1). Throughout most of the 1990s, CBO's baseline for discretionary spending assumed adherence to the statutory limits that were originally enacted in 1990 (and extended in 1993 and 1997).[8] However, the discretionary spending limits expire after 2002, and it is clear from appropriations enacted in recent years that they are no longer a useful measure of current policy or a viable guideline for projecting discretionary spending in the future. (For example, the adjusted limit on discretionary outlays for 2002—$576 billion—is about $71 billion below CBO's estimate of discretionary outlays for 2001.)

The baseline is intended to provide a neutral, nonjudgmental foundation for assessing policy options. It is not "realistic," because tax and spending policies will change over time. Neither is it intended to be a forecast of future budgetary outcomes. Rather, the projections presented in this report reflect CBO's best judgment about how the economy and other factors will affect federal revenues and spending under existing policies.

Recent Changes to the Budget Outlook

The prospects for the budget in CBO's current outlook are more favorable, as noted earlier, than those presented in July 2000. The total surplus for fiscal year 2000 was slightly above CBO's earlier projection, and the improvement for 2001 is expected to be even greater. Moreover, in the current outlook, the increases CBO projects in the surplus continue to rise over the next 10 years (see Table 1-3).

For 2000, the budget recorded a total surplus of $236 billion—$4 billion larger than CBO's estimate in July—and achieved an on-budget surplus of $86 billion. Revenues for the year came in $17 billion above expectations but were offset by $13 billion more in spending—almost entirely from the Emergency Supplemental Appropriations Act (H.R. 4425). That act shifted about $8 billion in salary and benefit payments back into 2000 that had previously been pushed forward into 2001. Its repeal of other spending shifts and delays added $3 billion more to the year's outlays. The bill also provided funds for national security activities, such as operations in Kosovo, and for domestic disaster assistance and counternarcotics efforts.

For 2001, CBO estimates that the total surplus will reach $281 billion—a $13 billion jump from the amount projected six months ago. By 2010, projections show the total surplus growing to $796 billion rather than $685 billion, as CBO estimated last July. The on-budget surplus is expected to reach $484 billion, up $107 billion compared with July's projection.

CBO conventionally attributes the changes in its projections to three factors: recently enacted legislation; changes in the overall economic outlook; and other, technical factors that affect the budget. Those categorizations should be viewed with caution. For example, changes ascribed to legislation represent CBO's best estimates of the future effects of laws measured around the time they are enacted. But if a new law has effects that differ from those reflected in CBO's initial estimate, the differences will appear as technical "reestimates" in later revisions to the baseline. Distinguishing between economic and technical reestimates is similarly imprecise. CBO classifies changes in some factors that are related to the performance of the economy (for example, capital gains realizations) as technical reestimates because those changes are not directly driven by components of CBO's economic forecast (for example, inflation and interest rates). Despite such imperfections, tracking and classifying reestimates of revenues and spending as either legislative, economic, or technical can be useful to budget analysts as they try to evaluate a changing budget outlook.

Over the 2001-2010 period, the total change in projected surpluses relative to the July outlook is an increase of $441 billion. The overall improvement in the economic picture, despite a slowdown anticipated in 2001, adds $980 billion to surpluses over the 10 years—largely from higher revenues. A myriad of technical changes also contribute $59 billion to higher total surpluses. However, legislation enacted

8. Section 257(d) of the Deficit Control Act permits the use of "up-to-date concepts" in baseline budget projections.

Table 1-3.
Changes in CBO's Projections of the Surplus Since July 2000 (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001-2010
July 2000 Projection of Total Surplus[a]	268	312	345	369	402	469	523	565	625	685	4,561
Legislative Changes											
Revenues	-2	-2	-3	-3	-3	-4	-4	-5	-6	-5	-37
Outlays											
Discretionary	8	29	35	37	39	41	43	44	45	47	368
Mandatory											
Defense retiree health benefits	0	0	2	2	3	3	4	4	4	5	28
Medicaid	*	-1	-3	-5	-6	-8	-9	-10	-11	-12	-64
Medicare	4	8	7	7	8	8	9	10	11	12	84
Debt service	*	2	4	7	10	13	17	21	25	30	127
Other	*	2	2	2	2	2	2	2	3	2	18
Subtotal, mandatory	4	11	11	13	16	18	23	27	32	37	193
Subtotal, outlays	12	40	46	51	56	60	66	71	77	83	561
Total Impact on the Surplus	-14	-42	-49	-53	-59	-63	-70	-76	-83	-88	-598
Economic Changes											
Revenues	-6	7	32	56	72	88	106	128	148	173	802
Outlays											
Discretionary	*	*	*	-1	-1	-1	*	*	1	1	-1
Mandatory											
Medicaid	1	1	2	3	3	4	4	5	6	8	37
Social Security	1	2	1	2	2	3	4	5	6	7	35
Net interest (Rate effects)[b]	-12	-21	-13	-9	-8	-7	-5	-5	-5	-5	-89
Debt service	*	-1	-2	-5	-9	-14	-20	-27	-36	-46	-160
Other	3	4	2	*	*	-1	-2	-2	-2	-2	*
Subtotal, mandatory	-7	-14	-10	-9	-11	-15	-18	-24	-30	-38	-177
Subtotal, outlays	-7	-14	-10	-10	-12	-16	-19	-24	-29	-37	-178
Total Impact on the Surplus	1	21	42	66	84	103	124	151	177	210	980
Technical Changes											
Revenues	33	29	24	20	15	11	9	7	4	2	153
Outlays											
Discretionary	1	-3	*	*	-1	-3	-4	-5	-6	-7	-29
Mandatory											
Medicaid	5	7	9	10	10	10	10	11	10	11	92
Social Security	2	3	3	4	4	5	5	5	5	5	41
Debt service	-1	-2	-2	-3	-3	-3	-3	-2	-2	-1	-22
FCC spectrum receipts	3	2	-6	-9	0	0	*	0	*	*	-10
Other	-3	1	-1	3	*	6	4	3	4	5	23
Subtotal, mandatory	6	10	3	5	11	17	17	17	18	19	124
Subtotal, outlays	6	7	3	5	10	14	13	12	12	12	95
Total Impact on the Surplus	27	22	21	15	6	-3	-4	-6	-8	-10	59

(Continued)

Table 1-3.
Continued

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001-2010
All Changes											
Revenues	25	34	53	73	84	95	110	129	146	170	919
Outlays											
Excluding debt service	12	34	39	47	55	62	66	68	73	77	533
Debt service	*	*	-1	-1	-2	-4	-6	-9	-13	-18	-55
Subtotal, outlays	12	33	38	45	53	59	60	59	60	58	478
Total Impact on the Surplus	13	*	14	28	31	36	50	70	86	111	441
January 2001 Projection of Total Surplus	281	313	359	397	433	505	573	635	710	796	5,002

SOURCE: Congressional Budget Office.

NOTE: FCC = Federal Communications Commission; * = between -$500 million and $500 million.

a. Calculated from the variation of CBO's July 2000 baseline that assumes discretionary spending grows at the rate of inflation after 2000.

b. Includes the effect on proceeds earned on the balance of uncommitted funds, which is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

in the past several months is expected to decrease surpluses by $598 billion during that time, mostly because of additional spending on discretionary activities and health care programs.

Recent Legislation

CBO anticipates that legislation enacted since July—mainly appropriation action—will draw down projected surpluses from 2001 through 2010. Appropriations for 2001 and outlays from supplemental appropriations for 2000 push up projected discretionary spending by $368 billion over the period, the bulk coming in the later years. A large part of that change derives from extrapolating the higher appropriations for 2001 into the future.

Other legislative action, most of it incorporated in appropriation acts, boosts mandatory spending (by $65 billion, not including debt service) and decreases revenues (by $37 billion). Debt service attributable to legislative changes adds another $127 billion to mandatory outlays from 2001 through 2010.

Discretionary Spending. The Congress and the President enacted the 13 regular appropriations for 2001 in 10 acts, including the Consolidated Appropriations Act, 2001 (Public Law 106-554). That consolidated law incorporates by reference three regular appropriation bills and five other acts. One of those others is a miscellaneous discretionary spending bill that provides for some additional spending and a small across-the-board spending cut.

The appropriations for 2001 directly affect CBO's estimates of discretionary spending throughout the 2001-2010 period. In its July baseline, CBO extrapolated discretionary budget authority for 2001—$611 billion—from the appropriations for 2000. But the appropriation acts for 2001 actually provided a total of $637 billion in budget authority. That higher level affects baseline estimates of future discretionary outlays in two ways:

- First, only part of the additional budget authority approved for 2001 is expected to actually be spent in the current year. CBO thus projects only $8 billion more in discretionary outlays for 2001 relative to last July. The remainder of the higher budget authority appears as outlays in future years (since some programs spend their authority slowly).

- Second, CBO's current baseline now uses discretionary budget authority for 2001, rather than the 2000 level, as a basis for extrapolating to 2002 and throughout the projection period. CBO thus assumes a higher level of discretionary budget authority for 2002 through 2010 than it assumed in July—which leads to greater projected outlays.

For both of those reasons, the increase in discretionary spending relative to the July baseline jumps to $29 billion in 2002 and grows further, to $47 billion by 2010.

The largest change in discretionary spending was for defense: outlays rose by $3 billion in 2001 and by $8 billion in 2002. Relative to the July baseline, projected spending on transportation and education programs also increased—by $2 billion and $1 billion, respectively, for 2001, and by $5 billion and $6 billion for 2002. Other discretionary categories receiving appropriations at markedly higher levels than CBO had assumed in the July baseline include natural resources, health programs, income security programs, and justice activities.

One notable decrease to discretionary spending also resulted from legislation. The appropriation for 2001 for the Census Bureau was $4 billion lower than the amount projected in July. As described above, baseline rules require that future discretionary spending be extrapolated from the current year's budget authority. However, budget authority for the Census Bureau reached its 10-year peak in 2000 because of the decennial census, causing last year's baseline to overstate that spending for 2001 and beyond. Using the appropriated budget authority for 2001 as the base for projections brings spending for the census back down by several billion dollars. (However, those estimates similarly understate the amount necessary for the next decennial census, in 2010.) The change in spending on the census increases projected surpluses from 2001 through 2010 by $49 billion.

Mandatory Spending. The legislated changes to mandatory spending come primarily from two sources, and both affect health care programs. The first source is provisions of the National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) relating to health care benefits for military retirees. The second is the Medicare, Medicaid, and SCHIP Benefits Improvement and Beneficiary Protection Act of 2000 (H.R. 5661), which was incorporated in the Consolidated Appropriations Act, 2001.

The National Defense Authorization Act increases medical benefits, including prescription drug coverage, for retirees of the uniformed services who are age 65 and older. Currently, the Congress must appropriate funds for all health care benefits sponsored by the Department of Defense. But under the act, both the new and existing health benefits for those retirees become an entitlement beginning in 2003. Benefits will be paid for through a newly created trust fund that itself is financed by intragovernmental payments from the Department of Defense—although the general fund will have to cover any shortfalls.

CBO estimates that those benefits will add approximately $60 billion to mandatory spending from 2001 through 2010, about two-thirds of which will pay for the new benefits. Spending will increase by $6 billion beginning in 2003, with the added outlays growing to $9 billion by 2010. Those figures do not include receipts in the form of payments from the Department of Defense that will be appropriated to finance the benefits. But such receipts are expected to total only $29 billion over the period, leaving a net increase to mandatory spending of $31 billion. About $3 billion of that amount is recorded as higher Medicare spending, because CBO assumes that the improved benefits will cause retirees who are covered under both health plans to increase their use of medical services, including those that are paid for in part by Medicare. Thus, only $28 billion of the 10-year figure is attributed to mandatory defense spending.

The Medicare, Medicaid, and SCHIP Benefits Improvement and Beneficiary Protection Act of 2000 increased projected costs for Medicare but lessened the spending that CBO expected for Medicaid. The act raised costs in the Medicare program in several ways but primarily through larger payments to providers and to capitated health plans (such as health maintenance organizations, or HMOs, that accept a fixed reimbursement per beneficiary). Those increases came chiefly from bigger annual adjustments in payments to providers in the fee-for-service sector and a boost in the minimum payment to HMOs. All told, the act added an estimated $94 billion to Medicare spending from 2001 through 2010, with annual upticks starting at $4 billion in 2001 and rising to $14 billion by 2010. Higher premium payments by Medicare beneficiaries will offset $13 billion of those costs over the 10 years.

At the same time that it boosted Medicare costs, the act reduced Medicaid spending over the period by $64 billion—mostly by restricting states' use of a financing mechanism that exploited a loophole in federal regulations. States have been paying inflated rates for services provided in health care facilities that are operated by local governments. By financing the inflated payments with transfers from those local governments, states have been able to collect federal matching funds for those payments without actually increasing their Medicaid spending. The term "Medicare upper payment limit," or UPL, is used to refer to that mechanism because the total amount that states can gain is limited by the difference between total payments to providers under Medicaid's rules and what those payments would be under Medicare's. The act restricts, but does not entirely eliminate, spending related to the UPL mechanism.

Revenues. Legislation enacted since July—primarily the Community Renewal Tax Relief Act of 2000 (H.R. 5662)—is expected to modestly decrease revenues, and therefore surpluses, over the next 10 years. H.R. 5662 removes $26 billion from the projected receipts of individual income and corporate taxes by granting tax benefits (such as certain exemptions from capital gains taxes for individuals and wage credits for employers) to localities designated as renewal communities. Other legislation contributes varying amounts to the loss in revenues. For example, the FSC (Foreign Sales Corporation) Repeal and Extraterritorial Income Exclusion Act of 2000 (H.R. 4986) diminishes estimated revenues by about $4 billion over 10 years. The act decreases corporate tax revenues in part by allowing U.S. firms to exclude certain foreign trade income from their taxable income.

Economic Changes

Since July 2000, CBO has revised its economic assumptions, which improved the budget outlook over the 10-year period by $980 billion. The changes represent CBO's best judgment about the path of the economy over the next decade. (For a more extensive discussion of the economic outlook, see Chapter 2.) Compared with its previous forecast, CBO now anticipates a slowdown in 2001 but faster growth of real GDP in later years. Other changes for the near term include lower interest rates and slightly higher unemployment than CBO assumed in July. The economic changes primarily affect revenues, boosting them in relation to July's baseline by $802 billion over the 10 years.

Revenues. Over the 2001-2010 period, CBO now estimates that, on a fiscal year basis, real GDP will grow at an average annual rate of about 3.0 percent, up from the 2.8 percent projected last July. Faster growth of GDP implies enhanced incomes and corporate profits, which in turn can generate substantially larger revenues over time. In 2001, however, CBO estimates that revenues will actually be $6 billion lower than in the previous baseline, mainly because projected growth of real GDP dips by 0.7 percent in 2001 relative to the previous economic forecast. But beginning in 2002, projections of real GDP growth outstrip July's figures, bringing up CBO's estimates for revenues by increasing amounts over the remainder of the projection period.

Outlays. The impact of economic changes on projected outlays—a decrease of $178 billion over 10 years—is significantly smaller than their impact on revenues, but the result is the same: they increase projected surpluses. The effects on outlays are dominated by revisions to net interest, which boost projected surpluses, but those changes are partially offset by revisions in spending programs, which decrease surpluses.

Net interest is principally determined by two factors: the stock of outstanding debt and the prevailing set of interest rates. All of the economic changes taken together swell projected surpluses—mainly because of the hefty revisions to revenues described earlier—and therefore allow the stock of debt to decline faster than CBO previously estimated.

That effect saves $160 billion in debt service over 10 years, with most of the savings coming in the later years of the projection period. In addition, CBO's updated estimate of the interest rate on 10-year Treasury notes in fiscal year 2001 is down by 1.7 percentage points, dropping from 6.8 percent to 5.1 percent; for fiscal year 2002, the rate is lower by more than 1.3 percentage points, declining from 6.5 percent to 5.1 percent. Short-term Treasury rates are also lower (by 1 percentage point or more) in 2001 and 2002. Savings from such changes come to $12 billion in interest payments in 2001; they peak at $21 billion in 2002 and total $89 billion from 2001 through 2010.

In contrast, economic changes affecting the Medicaid and Social Security programs decrease surpluses compared with July's projections. Medicaid's costs depend on states' decisions about reimbursement rates for providers, which in turn relate to the wages of medical workers and other medical price indexes. As a result of higher estimates of rates of growth in those factors, Medicaid spending is projected to be $1 billion higher in 2001 than CBO estimated last summer. In 2010, those economic changes account for $8 billion in increased spending; over the 2001-2010 period, a total of $37 billion can be ascribed to their effects.

Similarly, Social Security costs are higher over the period. Inflation (which determines cost-of-living adjustments for beneficiaries) was higher than expected in 2000, creating a higher base for benefits over the 10-year projection span. In addition, since Social Security benefits are calculated from wages, CBO's projections of faster real wage growth relative to July mean bigger initial benefits for new beneficiaries in the future. The additional costs for Social Security occur largely in the later years of the decade and total $35 billion from 2001 through 2010.

Technical Changes

Technical revisions are defined as any changes that are not ascribed to new legislation or to changes in the macroeconomic forecast. In total, CBO expects changes resulting from technical factors to enlarge surpluses by $59 billion over the 2001-2010 period. However, that net amount comprises $153 billion in upward reestimates of revenues and $95 billion in higher spending—which largely offsets the budgetary impact of the revenue changes. The adjustments to revenues are mostly in the first half of the projection period; the increases in outlays occur throughout the 10 years but are somewhat larger from 2006 through 2010. Technical changes as a whole, therefore, raise estimated surpluses by $27 billion and $22 billion, respectively, in 2001 and 2002. But in 2006, technical changes begin to have an opposite, diminishing effect, and by 2010, they shave $10 billion from CBO's surplus projections.

Revenues. The technical adjustment to revenues is largest for 2001, with an expected hike of $33 billion. But that effect steadily weakens; in 2010, revenues increase by just $2 billion. Much of the upward technical reestimate reflects greater projected realizations of capital gains. CBO's revised projection is based on both higher-than-expected realizations in tax year 1999 and the high volume of stock transactions in tax year 2000 that should continue to unlock accrued gains even in the face of relatively stable or falling stock prices. The increase in revenues relative to July declines over the projection period as that capital gains effect fades. Also reflected in the upward revision is an effect stemming from collections of revenues for fiscal year 2000 that were greater than anticipated last July. Those collections create a higher initial starting point for projections and thus raise revenues throughout the period.

Outlays. Technical changes as a whole increase spending by $95 billion, but they are a mix of modifications that operate in both directions. Among the largest are upward revisions to Medicaid and Social Security spending, which are only partially offset by downward reestimates for Section 8 housing assistance, Medicare, and debt-service costs. Further offsetting those upward revisions are higher estimates of receipts from spectrum auctions.

The technical revisions to Medicaid mainly reflect higher spending that arose from states' use of the Medicare UPL financing mechanism discussed earlier.[9] CBO's previous projections did not fully

9. The Medicare, Medicaid, and SCHIP Benefits Improvement and Beneficiary Protection Act of 2000 restricted use of that mechanism, resulting in a legislative change that decreases baseline spending for Medicaid and for the most part offsets the technical change.

account for outlays related to that practice. In addition, the number of states engaging in it grew rapidly in 2000 as more states learned about the UPL loophole and hurried to exploit it and receive extra federal funds before the opportunity disappeared. The technical revisions CBO made in relation to UPL financing increase projected Medicaid outlays by $3 billion in 2001; that amount swells to $12 billion by 2010. Those changes and other small adjustments to Medicaid total $92 billion in additional spending over 10 years.

CBO also increased its estimates of Social Security expenditures, raising them by about $2 billion in 2001 and $5 billion annually beginning in 2006. That change results from revisions to the models CBO uses to calculate the average benefit for Social Security recipients. The program's benefits are based on the wages a beneficiary earns during his or her working years. Previously, CBO's model used inflation plus a historical average for growth in real benefits to calculate expected benefit growth over time. The revised projections now explicitly use estimated real growth in wages when calculating future benefits. (As discussed earlier, the effect that CBO estimates from faster real growth in wages relative to the July baseline is considered an economic change.)

Section 8 housing assistance, with $25 billion less in expenditures over the decade relative to July, is the source of most of the downward technical reestimate of discretionary spending. The change occurred because CBO modified its baseline to more accurately reflect the specifications in section 257 of the Deficit Control Act. For previous baselines, CBO implicitly assumed a gradually increasing stock of subsidized housing. Under the current approach, CBO assumes that the number of subsidized housing units remains the same as the number supported by funds provided through 2001.

Also offsetting the higher spending on Medicaid and Social Security are larger estimated receipts from Federal Communications Commission (FCC) spectrum auctions and lower debt-service costs. CBO revised upward its valuations of the spectrum licenses being auctioned by the FCC because of the significantly higher prices such licenses have brought in European countries over the past year and the robust bidding in similar ongoing auctions in the United States (see the fuller discussion in Box 4-1 on page 90). In addition, the higher surpluses that result from all of the technical changes create debt- service savings that total $22 billion over 10 years.

The Outlook for Federal Debt

Federal debt falls into two broad categories—debt held by the public and debt held by government accounts. Debt held by the public—the most meaningful measure of debt in terms of its relationship to the economy—is issued by the federal government to raise cash. The Treasury regularly sells securities to the public that currently range in maturity from three months to 30 years. Most of that debt is marketable —that is, freely traded in financial markets. Owners of debt held by the public include pension plans, mutual funds, individuals, state and local governments, foreign institutions, banks, and the Federal Reserve.

Debt held by government accounts, in contrast, is an intragovernmental IOU and involves no cash transactions. It is used as an accounting device to track cash flows relating to specific federal programs.

In addition to the differences in how the two kinds of debt relate to the economy, debt held by the public and debt held by government accounts follow different trends in CBO's baseline. Holdings by government accounts have risen steadily for several decades and are expected to continue doing so. However, debt held by the public, after growing for nearly 30 years, began to decline in 1998.

That decline is projected to continue under CBO's baseline assumptions for the 2001-2011 period. In fact, surpluses are projected to grow large enough to allow the federal government to retire all available debt held by the public and begin to hold large amounts of cash or other assets. In such a situation, another measure—net indebtedness—would be necessary to capture the full impact of surpluses on the government's financial position. As a measure of both debt and investments, net indebtedness would replace debt held by the public as the most complete gauge of the government's participation in the financial markets.

Reducing Debt Held by the Public

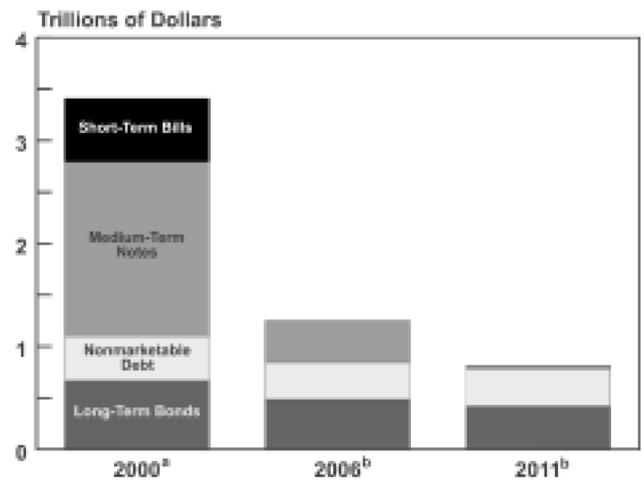
From 1969 through 1997, the Treasury sold ever-increasing amounts of debt to finance continuing deficits. As a result, debt held by the public climbed each year, peaking at $3.8 trillion in 1997. That trend has now reversed. At the end of fiscal year 2000, debt held by the public had dropped by $363 billion, to $3.4 trillion. The decline as a percentage of GDP has been even more dramatic. After reaching a plateau of about 50 percent of GDP from 1993 to 1995, that share fell to 35 percent in 2000 (see Figure 1-1).

CBO's baseline indicates that if current policies remain in effect, debt held by the public will continue to fall. If surpluses accrue as projected, much of the nation's current debt will be paid down over the next several years. However, a part of it—including some long-term bonds and savings bonds—will not be available for redemption during CBO's 10-year projection period. Therefore, in any given year, some debt will remain outstanding and incur interest costs, regardless of the size of the surplus. In the baseline, debt falls each year from 2001 to 2005 by roughly the amount of the projected surplus.[10] In 2006, CBO estimates, debt held by the public will reach a level at which the remaining debt is not available for redemption. That remaining, unavailable stock of debt also declines each year, eventually falling to $818 billion in 2011 (see Table 1-4). From 2006 through 2011, the baseline accounts for residual surpluses (amounts not used to pay off debt) as uncommitted funds.[11]

Figure 1-1.
Debt Held by the Public as a Share of GDP, Fiscal Years 1940-2000

SOURCE: Congressional Budget Office.

Figure 1-2.
Composition of Debt Held by the Public, Fiscal Years 2000, 2006, and 2011



SOURCE: Congressional Budget Office.

a. Actual debt.

b. Debt not available for redemption under CBO's assumptions.

How Much Debt Is Not Available for Redemption? Most of the debt issued by the Treasury is not "callable" (cannot be redeemed on demand before maturity) and therefore will remain outstanding until it reaches its maturity date or is repurchased in the markets. Under CBO's assumptions, debt that is un-

10. Debt held by the public does not change exactly by the amount of the surplus because of a number of factors broadly labeled "other means of financing" that affect the government's borrowing needs. The largest of those factors is the capitalization (up-front disbursement of money) of student loans and loans from other such programs. Other factors include seigniorage, changes in the government's cash balances, and premiums paid by the Treasury in lieu of future interest payments when repurchasing bonds. In total, those factors add as much as $20 billion to borrowing in every year between 2001 and 2011.

11. In previous baselines, CBO used the term "excess cash" to refer to those residual surpluses.

available for redemption totals $1.25 trillion in 2006; its level drops thereafter (see Figure 1-2). However, the stock of such debt is measured at the end of the year, and those totals do not explicitly include any short-term securities that the Treasury might issue to fund monthly or seasonal swings in the government's financing needs.

The largest portion of unavailable debt is 30-year bonds, most of which are not slated to mature until after 2011. The Treasury instituted a program last year to repurchase those bonds in the private markets, and it bought back $30 billion of long-term debt in calendar year 2000. It has also announced its intent to continue the buyback program. However, over $600 billion in 30-year bonds is currently outstanding, and it is unlikely that all, or even a significant share, of the holders of those bonds will choose to sell them at prices that the government is willing to pay. CBO assumes that the Treasury will continue its buyback program at approximately the current level through next year but that after 2002, the amount of debt it repurchases will dwindle.

Debt that is held in nonmarketable form (for example, savings bonds or securities issued to state and local governments) and serves other purposes besides financing government activities also adds to total debt unavailable for redemption. Unless the government chooses to discontinue such programs, nonmarketable debt will be issued according to trends unrelated to the government's financing requirements and remain outstanding through 2011.

CBO's calculations of unavailable debt also include some medium-term securities, such as five-year and 10-year notes. The Treasury has broad authority to make decisions regarding when and how much of each maturity to issue. About $110 billion in five- and 10-year notes was issued in 2000. The size of such issues in future years determines how much medium-term debt will remain outstanding in 2011. CBO's baseline makes the simplifying assumption that no debt with a maturity of five or more years will be issued after 2002. As a result, CBO's estimate of unavailable debt does not include five-year notes after 2006 and has diminishing amounts of 10-year notes, the last of which would mature in 2012.

Uncommitted Funds. If the surpluses projected in CBO's baseline materialize, the Treasury's cash on hand would exceed its ability to retire debt held by

Table 1-4.
CBO's Projections of Debt Held by the Public and Net Indebtedness at the End of the Year
(By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818
Balance of Uncommitted Funds[a]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28	466	1,003	1,608	2,338	3,164
Net Indebtedness	3,410	3,148	2,848	2,509	2,131	1,714	1,223	662	36	-669	-1,460	-2,346
Memorandum:												
Debt Held by the Public as a Percentage of GDP	34.7	30.5	26.2	21.9	17.7	13.5	9.4	8.1	7.1	6.1	5.5	4.8

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

the public in each year from 2006 through 2011. Under such circumstances, the Congress and the President might decide to cut taxes or increase spending, or both, to dissipate some or all of the surpluses that were not needed to pay off publicly held debt. However, CBO's baseline uses only current tax and spending policies as its foundation. Thus, its projections simply assume that the Treasury will accumulate all funds exceeding the amounts needed to retire available debt.

In 2006, CBO's baseline shows a relatively small amount of uncommitted funds—$28 billion—which is within the range of the Treasury's normal operating balances. But those funds grow rapidly after that year, and the balance of uncommitted funds is projected to reach an immense stock of $3.2 trillion in 2011. The baseline assumes that such funds will be invested at a rate of return equal to the average rate projected for Treasury bills and notes. However, CBO makes no explicit assumptions about how much of those funds the Treasury would invest through either its current arrangements with banks and the Federal Reserve or any other investments that might be chosen.

Net Indebtedness. Since the retiring of debt held by the public is limited by how much can be redeemed, CBO displays the full effect of surpluses on the government's financial position with a new measure—net indebtedness. Net indebtedness is a so-called stock measure that combines outstanding debt held by the public and the balance of uncommitted funds, thus showing the cumulative total of all annual deficits and surpluses. (In 2008, for example, $1,039 billion of debt held by the public that is not available for redemption minus the $1,003 billion of uncommitted funds gives a net indebtedness of $36 billion; see Table 1-4.) Under CBO's baseline projections, net indebtedness turns negative in 2009, meaning that

Table 1-5.
CBO's Projections of Net Indebtedness at the End of the Year Under Alternative Scenarios for Debt Reduction (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Dedicate Only Off-Budget Surpluses to Debt Reduction After 2001												
Debt Held by the Public	3,410	3,148	2,991	2,822	2,640	2,435	2,210	1,965	1,699	1,411	1,103	818
Balance of Uncommitted Funds[a]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	42
Net Indebtedness	3,410	3,148	2,991	2,822	2,640	2,435	2,210	1,965	1,699	1,411	1,103	776
Dedicate Both Off-Budget Surpluses and the Surpluses in the Medicare Hospital Insurance Trust Fund to Debt Reduction After 2001												
Debt Held by the Public	3,410	3,148	2,955	2,747	2,524	2,279	2,011	1,724	1,418	1,089	878	818
Balance of Uncommitted Funds[a]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	133	434
Net Indebtedness	3,410	3,148	2,955	2,747	2,524	2,279	2,011	1,724	1,418	1,089	745	384

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

Table 1-6.
CBO's Projections of Gross Federal Debt at the End of the Year
(By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818
Debt Held by Government Accounts												
Social Security	1,007	1,164	1,337	1,524	1,727	1,948	2,186	2,443	2,719	3,012	3,324	3,655
Other government accounts[a]	1,212	1,290	1,379	1,470	1,561	1,653	1,753	1,853	1,952	2,054	2,159	2,265
Total	2,219	2,454	2,716	2,995	3,288	3,601	3,940	4,295	4,671	5,067	5,483	5,919
Gross Federal Debt	5,629	5,603	5,564	5,503	5,418	5,315	5,191	5,423	5,710	6,006	6,361	6,737
Memorandum:												
Debt Subject to Limit[b]	5,591	5,566	5,528	5,472	5,393	5,295	5,172	5,405	5,692	5,988	6,344	6,721

SOURCE: Congressional Budget Office.

a. Mainly Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Airport and Airway Trust Fund.

b. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit. The current debt limit is $5,950 billion.

the balance of uncommitted funds exceeds the remaining debt owed to the public.

Alternative Policy Scenarios for Debt Reduction. Policymakers have recently discussed proposals that would devote only certain portions of total surpluses to paying down debt and apply the remaining funds to decreases in taxes or increases in spending. Two such scenarios are dedicating just the off-budget—primarily Social Security—surpluses to reducing debt and dedicating both the off-budget and Medicare Hospital Insurance (HI) surpluses to debt reduction (see Table 1-5). Both of those alternatives have outcomes for debt that differ substantially from the baseline. If only off-budget surpluses were used to reduce debt, net indebtedness would fall to $776 billion in 2011. However, the Treasury would be able to reduce the available debt only to $818 billion; therefore, CBO estimates that the budget would record $42 billion in uncommitted funds in 2011. If off-budget and HI surpluses were devoted to retiring debt, net indebtedness would be reduced further, to $384 billion in 2011. Under that scenario, the budget would show uncommitted funds in two years, for a cumulative balance of $434 billion by 2011.

Gross Measures of Federal Debt

Gross federal debt—and a similar measure, debt subject to limit—counts debt issued to government accounts as well as debt held by the public. In addition to selling securities to the public, the Treasury has issued about $2.2 trillion in securities to various government accounts (mostly trust funds). The funds redeem securities when they need to pay benefits; in the meantime, the government both pays and collects interest on that debt.

Debt issued to government accounts is handled within the Treasury and does not flow through the credit markets. Those transactions are intragovernmental and have no direct effect on the economy. Similarly, interest on those securities is simply an intragovernmental transfer: it is paid by one part of the government to another part and does not affect the total deficit or surplus.

Gross Federal Debt. The future path of gross federal debt will be determined by the interaction of falling levels of debt held by the public and rising levels of debt held by government accounts. The total holdings of government accounts grow approximately in step with projected trust fund surpluses. The largest balances of such debt are in the Social Security trust funds ($1.0 trillion at the end of 2000) and the retirement funds for federal civilian employees ($512 billion).

Debt held by government accounts has risen steadily over time and is expected to continue rising as the Social Security and other trust funds continue to record large surpluses. The balance of the Social Security trust fund is projected to mushroom to $3.7 trillion by 2011 and the balance of all trust funds to more than $5.9 trillion (see Table 1-6 on page 17). Therefore, even if debt held by the public were completely eliminated, gross debt would still measure almost $6.0 trillion in 2011. Under CBO's baseline projections, gross debt falls in every year from 2001 to 2006 as the paying down of debt held by the public outpaces the rise in debt held by government accounts. After 2006, when the reduction of publicly held debt is limited to maturing securities, gross debt begins to grow again, reflecting the continued increase in trust fund balances.

Debt Subject to Limit. The Congress sets a limit on the Treasury's authority to issue debt. That ceiling —which currently stands at $5.95 trillion—applies to securities issued to government accounts as well as those sold to the public. Debt subject to limit is practically identical to gross federal debt. The minor differences between the two arise chiefly because securities issued by agencies other than the Treasury, such as the Tennessee Valley Authority, are exempt from the debt limit.

Since trust funds and other government accounts as a whole will continue to swell even as surpluses are projected to continue in the total budget, debt subject to limit in the baseline follows a path similar to that for gross debt. In other words, it falls until 2006 and then begins rising, eventually reaching $6.7 trillion by 2011. Under those projections, the debt ceiling would be reached in 2009—mostly as a result of the $5.1 trillion in debt held by government accounts.

Federal Funds and Trust Funds

The budget comprises two groups of funds: trust funds and federal funds. Trust funds are those programs so labeled in legislation; federal funds include all other transactions with the public. Over 60 percent of federal spending is derived from federal funds.

The federal government has more than 150 trust funds, although fewer than a dozen account for the vast share of trust fund dollars. Among the largest are the two Social Security trust funds (the Old-Age and Survivors Insurance and the Disability Insurance funds) and those dedicated to Civil Service Retirement, Medicare Hospital Insurance (Part A), and Military Retirement. Trust funds have no particular economic significance; they function primarily as accounting mechanisms to track receipts and spending for programs that have specific taxes or other revenues earmarked for their use.

Trust funds do not hold separate cash balances. When a trust fund receives payroll taxes or other income that is not currently needed to pay benefits, the excess is loaned to the Treasury. If the rest of the budget is in deficit, the Treasury borrows less from the public than would otherwise be required to finance current operations. If the rest of the budget is in balance or in surplus, the Treasury uses the cash from trust fund programs to retire outstanding debt held by the public.

The process is reversed when a trust fund's income falls short of its expenses. Then, the federal government must raise the necessary cash by boosting taxes, reducing other spending, borrowing more from the public, or (if the total budget is in surplus) retiring less debt.

Including the cash receipts and expenditures of trust funds in the budget totals with other federal programs is necessary to assess the effect of federal activities on the Treasury's external borrowing needs. CBO, the Office of Management and Budget (OMB), and other fiscal analysts therefore focus on the total (or unified) surplus or deficit because it is an overall measure of the federal government's cash operations, which include trust fund programs, and provides the most relevant picture of the government's current impact on the economy.

In 2001, the total surplus is estimated to be $281 billion, which can be divided into a federal funds surplus of $51 billion and a trust fund surplus of $231 billion (see Table 1-7). That division is somewhat misleading, though, because trust funds receive much of their income in the form of transfers from federal funds. Such transfers shrink the federal funds surplus and augment trust fund surpluses. Those intragovernmental transfers will total $319 billion in 2001. The largest of them include interest paid to trust funds ($154 billion); contributions from the general fund to Medicare, principally Supplementary Medical Insurance (SMI), or Part B ($79 billion); and govern-

Table 1-7.
Trust Fund Surpluses (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Social Security	152	157	172	188	202	221	238	257	276	294	312	331
Medicare												
Hospital Insurance (Part A)	30	29	36	39	41	40	44	41	41	39	37	34
Supplementary Medical Insurance (Part B)	*	-5	-1	-1	-1	*	3	2	2	3	3	3
Subtotal	30	24	35	39	40	40	47	43	43	42	40	38
Military Retirement	6	7	7	8	9	9	10	11	11	12	13	14
Civilian Retirement[a]	31	32	31	31	31	31	31	31	32	32	32	33
Unemployment	9	6	6	5	2	2	1	1	-1	*	1	2
Highway and Mass Transit	3	*	-1	-2	-2	-2	-2	-1	*	*	*	1
Airport and Airways	2	2	2	2	3	3	4	4	5	6	7	8
Other[b]	6	3	4	4	4	4	4	4	4	4	4	4
Total Trust Fund Surplus	238	231	257	274	288	308	333	349	369	389	409	430
Federal Funds Deficit (-) or Surplus	-2	51	56	86	109	125	172	223	266	321	387	459
Total Surplus	236	281	313	359	397	433	505	573	635	710	796	889
Memorandum:												
Net Transfers from Federal Funds to Trust Funds	333	319	333	358	385	416	447	480	516	554	596	640

SOURCE: Congressional Budget Office.

NOTE: * = between -$500 million and $500 million.

a. Includes Civil Service Retirement, Foreign Service Retirement, and several small retirement funds.

b. Primarily Railroad Retirement, federal employees' health and life insurance, Superfund, and various veterans' insurance trust funds.

ment agency contributions to retirement funds on behalf of present and past employees ($76 billion). Without intragovernmental transfers, the trust funds would have an overall deficit each year that would grow from $88 billion in 2001 to $211 billion in 2011.

Intragovernmental transfers reallocate costs from one part of the budget to another. For example, transfers representing government contributions to retirement funds attribute a portion of anticipated future retirement costs to current personnel budgets and require agencies to bear a greater share of the full cost of their hiring decisions. Such transfers, however, do not change the total surplus or the government's borrowing needs. As a result, they have no effect on the economy or on the government's future ability to sustain spending at the levels indicated by current policies.

All major trust funds except the Medicare SMI fund are now generating surpluses, and CBO projects that they will continue doing so through 2011. (The flows into and out of the SMI fund, unlike those of other major trust funds, are designed to be approximately in balance each year, although the fund maintains a small contingency reserve. CBO expects that the fund will run small deficits between 2001 and 2005 to reduce accumulated holdings.) The Social Security trust funds are currently running a combined annual surplus of $157 billion. By 2011, that surplus is expected to increase to $331 billion. But it will begin to shrink shortly afterward when large numbers of baby boomers begin to retire. (Some proposals have suggested shoring up the Social Security trust funds by enabling them to purchase private securities. See Box 1-2 for a discussion of the budgetary treatment of government purchases of private securities.)

Comparing CBO's and the Clinton Administration's Baseline Projections

On January 16, 2001, the Clinton Administration issued its baseline budget projections—which are known as current-services projections—for 2002 through 2011.[12] Like CBO, the Administration's Office of Management and Budget concludes that the surplus will climb steadily through 2011. That projection—again, like CBO's—assumes that revenues and mandatory spending continue to be governed by current laws and that discretionary appropriations keep pace with inflation.

Although CBO and OMB both project large surpluses, those projections differ in certain respects. The 10-year total surplus that CBO projects for 2002 through 2011 is $613 billion larger than the cumulative surplus OMB anticipates (see Table 1-8). Although that discrepancy of $613 billion may seem large, it results from differences of only 1.1 percent in total revenues projected for the period and 1.4 percent in total projected outlays. CBO's projections of on-budget surpluses are $676 billion larger over the 10-year period than OMB's; in contrast, CBO's cumulative off-budget surpluses are $63 billion lower than the corresponding OMB projections.

Nearly half of the difference (or $299 billion) between CBO's and the Clinton Administration's projections of the 10-year surplus derives from variations in the two sets of revenue projections. CBO's projections are higher in each year of the budget period—as much as $52 billion higher in 2004. Those differences taper off in later years and drop to $13 billion in 2011 ($39 billion in higher projected on-budget revenues offset by $26 billion in lower off-budget tax receipts).

CBO projects higher revenues than does OMB even though its projection of growth in nominal GDP over the baseline period is lower than that of the Administration. CBO's economic projection of somewhat slower growth in aggregate income reduces its projection of revenues relative to the Administration's by about $300 billion over 10 years. But that downward effect is more than offset by CBO's projection of faster growth in tax receipts for a given level of income in the economic forecast, which increases its projection of revenues by about $600 billion relative to the Administration's.

12. See Office of Management and Budget, *FY 2002 Economic Outlook, Highlights from FY 1994 to FY 2001, FY 2002 Baseline Projections* (January 2001).

Box 1-2.
Budgetary Treatment of Government Purchases of Private Securities

Government purchases of private securities, including corporate bonds and equities, pose an interesting and unprecedented dilemma for federal budgeteers. Long considered an esoteric topic, such purchases were discussed during the 106th Congress (for example, in considering President Clinton's Social Security plan and bills changing the investment practices of the Railroad Retirement Board), thus hastening the need to reassess their budgetary treatment.

The Office of Management and Budget's Circular A-11 contains some direction for how federal purchases of private securities should be treated. It specifies that the purchases should be considered outlays at the time they are made and offsets to outlays (offsetting receipts) when the securities are sold. Interest and dividend payments are also to be classified as offsetting receipts. Under that treatment, the budget would not distinguish between using $10 million to purchase private securities and spending the same amount to procure office supplies or an office building. Indeed, Circular A-11 directs that all federal purchases of assets, whether financial or physical, be accorded that same treatment and be shown as budgetary outlays. Its approach is consistent with the practice of recording most government transactions on a cash basis.

But some experts question whether the purchase of private securities should be treated as the circular directs. They argue that the securities would be purchased as a means of financing future government obligations and would not constitute a use of budgetary resources. Those purchases would in some senses be the mirror image of government borrowing—which is not recorded in the budget. According to that interpretation, it would be more appropriate to account for such purchases not as government outlays but rather as part of the process by which the government finances its activities. Treating purchases in that way would be comparable to the treatment accorded to transactions of the financing accounts for credit pro grams, the profits from the government's sale of its gold reserves, or the seigniorage on the coins it issues.[1]

In recent years, numerous proposals to strengthen the nation's system of retirement income have called for new, individually based savings accounts, or personal retirement accounts (PRAs).[2] Some proposals have made PRAs compulsory, whereas others have made them voluntary. In some proposals, investment of funds from the accounts would be administered by the federal government, while in others, investment would be privately administered.

If all of the benefits and risks of the PRAs and their accumulations accrue to the individual investor (as they do for current individual retirement accounts and the federal employees' Thrift Savings Plan), then there would be no reason to incorporate these accounts into the federal budget. Under some proposed PRA designs, however, the federal government (and therefore taxpayers) would retain a substantial interest in the assets that accumulated in the accounts. For example, a proposal might specify that 2 percentage points of the current Social Security payroll tax be directed to PRAs and that an account holder's Social Security benefits be reduced dollar for dollar for payments from the account. Many, if not most, account holders would receive no net gain from such PRAs. In that case, those account holders have become investing agents for the federal government, a situation that many people would consider much like direct government investing. A strong case could be made that the cash flow associated with that particular form of PRA should be included in the federal budget, and at that point, the issue of the appropriate budgetary treatment for federal purchases of private securities would arise.

1. Those items are not recorded in the budget (in other words, they do not contribute to deficits or surpluses). However, they are regarded as "means of financing" because they increase or decrease the amount that the government needs to borrow to finance all of its activities.

2. See Congressional Budget Office, *The Budgetary Treatment of Personal Retirement Accounts* (March 2000).

Table 1-8.
Comparison of CBO's Baseline with OMB's Current-Services Baseline (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2011
CBO's January 2001 Baseline												
Revenues	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447	27,886
On-budget	1,630	1,703	1,782	1,864	1,950	2,040	2,136	2,243	2,360	2,489	2,628	21,195
Off-budget	504	532	561	589	620	649	680	712	746	782	819	6,691
Outlays												
Discretionary	646	682	710	730	750	766	782	804	824	845	866	7,759
Mandatory	1,002	1,061	1,112	1,185	1,270	1,328	1,401	1,489	1,582	1,681	1,787	13,896
Net interest and proceeds earned on the balance of uncommitted funds[a]	205	179	163	142	116	90	60	27	-10	-51	-95	622
Total	1,853	1,923	1,984	2,056	2,137	2,184	2,243	2,320	2,396	2,475	2,558	22,277
On-budget	1,506	1,561	1,611	1,669	1,738	1,773	1,820	1,884	1,943	2,005	2,070	18,073
Off-budget	348	361	373	388	399	411	423	437	453	470	489	4,204
Surplus	281	313	359	397	433	505	573	635	710	796	889	5,610
On-budget	125	142	171	196	212	267	316	359	417	484	558	3,122
Off-budget	156	171	188	201	221	238	257	276	294	312	331	2,488
OMB's January 2001 Current-Services Baseline												
Revenues	2,125	2,210	2,301	2,401	2,525	2,649	2,788	2,934	3,088	3,257	3,434	27,587
On-budget	1,620	1,678	1,741	1,811	1,898	1,994	2,098	2,210	2,328	2,455	2,589	20,802
Off-budget	504	532	560	589	626	656	690	725	760	803	845	6,786
Outlays												
Discretionary	654	682	710	728	749	769	790	811	832	855	876	7801
Mandatory	1,004	1,059	1,111	1,174	1,263	1,327	1,408	1,503	1,600	1,704	1,822	13,971
Net interest and proceeds earned on the balance of uncommitted funds[a]	210	192	174	155	133	108	81	51	18	-19	-75	818
Total	1,868	1,933	1,994	2,058	2,145	2,204	2,279	2,365	2,450	2,540	2,623	22,591
On-budget	1,522	1,575	1,628	1,679	1,752	1,796	1,854	1,923	1,987	2,052	2,110	18,356
Off-budget	346	358	366	379	393	408	425	442	463	488	514	4,235
Surplus	256	277	307	343	380	446	509	570	638	717	810	4,996
On-budget	98	103	113	133	146	198	244	287	341	402	479	2,446
Off-budget	158	174	194	210	234	248	266	282	297	315	331	2,551

(Continued)

On the spending side, CBO's estimates of total outlays are $314 billion lower than those of the Administration for the 2002-2011 period. However, nearly two-thirds of that difference—or about $200 billion—comes from CBO's estimates of lower net interest payments fueled by the lower interest rates and debt levels that it projects over the 10 years.

Total discretionary spending under CBO's baseline is similar to the totals estimated by the Administration for the period. However, components of the two baselines differ for 2001 and 2002. In 2001, CBO expects agencies to spend budget authority (including prior balances) more slowly than does OMB; as a result, CBO's estimate of outlays for discretionary programs is $8 billion lower than OMB's estimate. For 2002, the upcoming budget year, CBO's and OMB's projections of total discretionary outlays are similar, but that similarity masks differences in the defense and nondefense categories.

For the defense discretionary category, CBO's outlay estimate for 2002 exceeds the Administration's by about $7 billion—continuing a pattern of

Table 1-8.
Continued

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2011
					Difference (CBO minus OMB)							
Revenues	10	26	42	52	45	40	27	21	19	14	13	299
On-budget	10	25	41	53	52	46	38	33	32	35	39	394
Off-budget	*	1	1	-1	-6	-7	-11	-12	-14	-21	-26	-94
Outlays												
Discretionary	-8	1	*	1	2	-3	-8	-7	-8	-10	-10	-43
Mandatory	-2	2	1	11	7	1	-7	-14	-18	-23	-35	-75
Net interest and proceeds earned on the balance of uncommitted funds	-5	-13	-11	-13	-17	-18	-21	-24	-28	-31	-20	-196
Total	-15	-10	-11	-1	-8	-20	-36	-45	-54	-65	-65	-314
On-budget	-16	-14	-17	-10	-14	-23	-35	-39	-44	-47	-40	-283
Off-budget	2	4	7	9	6	4	-2	-6	-11	-18	-25	-32
Surplus	25	36	52	54	53	59	63	66	73	79	78	613
On-budget	27	39	58	63	65	69	72	72	76	82	79	676
Off-budget	-2	-3	-6	-9	-12	-10	-9	-6	-3	-3	-1	-63

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: * = between -$500 million and $500 million.

a. “Uncommitted funds” is CBO’s term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

recent years in which CBO’s estimates of defense spending for the budget year have exceeded those of the Administration.[13] For the nondefense discretionary category, CBO’s outlay estimate for 2002 is $7 billion lower than OMB’s and, like its estimate for 2001, generally reflects CBO’s expectation that certain agencies will spend new budget authority and prior balances more slowly than OMB expects.

Over time, differences in spending between the two sets of estimates are much smaller and can be explained mostly by variations in the projected inflation rates used to adjust budget authority in the future (the GDP deflator and the employment cost index for wages and salaries). Those rates are slightly lower in CBO’s view than in the Administration’s and therefore generate marginally lower annual outlays.

For mandatory spending, CBO and OMB project similar totals over the 2002-2011 period. Within those totals, however, there are some variances. In particular, CBO’s estimate of Social Security outlays is $127 billion lower than OMB’s for the 10-year period. That difference is offset by CBO’s estimate of Medicare outlays, which is $130 billion higher over that time. In the case of Social Security, OMB projects higher spending than CBO does because, overall for the 10-year period, it assumes slightly larger increases for cost-of-living adjustments in benefit payments, additional costs for more disability awards related to a redesign of the award process, slightly bigger caseloads, and faster growth in average benefits. In the case of Medicare, OMB projects lower spending than does CBO because it assumes a smaller number of disabled enrollees and because it makes different assumptions about the budgetary effects of adjusting Medicare+Choice payments for differences in health status.

13. For a discussion of defense spending and differences between CBO’s and the Administration’s estimates, see Congressional Budget Office, *An Analysis of the President’s Budgetary Proposals for Fiscal Year 2001* (April 2000), Appendix B.

Discrepancies between CBO's and OMB's projections of net interest (including the proceeds earned on uncommitted funds) result mostly from different projections of future interest rates and different assumed levels of debt. CBO's projections of short-term interest rates are about 1 percentage point lower than OMB's in the near term and 0.4 percentage points lower in later years. CBO's projections of long-term rates are also lower than OMB's through 2005; thereafter, they are the same. CBO projects higher surpluses through 2011 than does OMB, which results in lower projections of debt in the future. The combination of lower rates and less debt leads to projected net interest costs over the 2002-2011 period that are $196 billion lower under CBO's baseline than in OMB's estimates.

The Expiration of Budget Enforcement Procedures

Lawmakers are approaching a crossroads in the federal budget process. The major enforcement procedures under the Deficit Control Act, as modified by the Budget Enforcement Act of 1990 and subsequent extensions, expire at the end of fiscal year 2002. Those procedures—the annual limits on discretionary appropriations and the pay-as-you-go (PAYGO) requirement for new mandatory spending and revenue laws—have formed the basic framework for budgetary decisionmaking for the past decade.

Barring a dramatic reversal of current trends, the expiration of the discretionary caps and PAYGO requirement will occur in a vastly different budget and fiscal environment than that existing when those procedures were first put in place (1990) and later extended (1993 and 1997). The discretionary caps and PAYGO requirement were instituted during a time of large deficits. They were intended to help reduce and control those deficits by ensuring that new legislation did not make projected deficits bigger. With the emergence of surpluses, the objective has changed.

In a time of surpluses, the discretionary caps and PAYGO requirement, when enforced, generally bar legislative actions that would make projected surpluses smaller. Although preserving surpluses may serve important objectives—chief among them that of reducing federal debt—it may be a goal that is increasingly difficult to sustain if total surpluses materialize at the record-setting levels now projected. Although the goal of lawmakers to preserve the off-budget (Social Security) portion of those surpluses for reducing public debt has imposed a new informal constraint on budget legislation, the emergence last year of the first large on-budget surplus—and projections of such amounts in the future—may have made that constraint less restrictive than it was when total budget surpluses first appeared in 1998.

For most of the 1990s, the consensus to reduce and eliminate the deficit made it easier for lawmakers to maintain the budgetary disciplines they had put in place to carry out that accord. However, no overall agreement has developed for the use of on-budget surpluses to replace the one that had been forged to eliminate the deficit. Without such an agreement, and for other reasons, the discretionary caps and PAYGO requirement have come under increasing stress. In 1999 and 2000, for example, lawmakers enacted record levels of emergency appropriations—which are effectively exempt from budget enforcement procedures—and used other funding devices to increase discretionary spending in excess of the caps set in 1997. For 2001, lawmakers set new, higher caps to accommodate increases in discretionary spending—the new outlay cap is about $60 billion higher than the one set in 1997—and eliminated the PAYGO balance for the year. That action obviated the need to offset an estimated $10.5 billion drop in the surplus caused by new mandatory spending and tax laws enacted during the last session of the 106th Congress.

The current period of unprecedented budgetary prosperity raises fundamental questions about how lawmakers should budget in a time of surpluses. Budgeting is a process for setting priorities and allocating scarce resources. Sustained surpluses of the magnitude now projected would retire all available debt held by the public in the next few years. What should be lawmakers' overriding budgetary objective? Is it possible in the current environment to structure a budget process with constraints? Should limits of the current type remain in effect? If so, what should those limits be, and how should they be structured? One current proposal, known as the "lockbox," would establish procedures to preserve minimum amounts of surpluses for certain purposes—Social Security, Medicare, debt reduction, and other uses. That approach might impose budget discipline, but it could also make the process of budgeting more difficult and inflexible if future surpluses did not materialize at the levels now projected.

With this budgetary environment as a backdrop, lawmakers will consider whether or in what form the discretionary caps and PAYGO requirement should be extended. Because the context for such a debate is now so different from that in earlier years, it may prompt a wider examination of the budget process and related issues. For example, the absence of overall agreement on what to do with surpluses may have led to delays in enacting budget legislation—especially appropriation bills. To help ease such tie-ups, some lawmakers advocate converting the annual budget cycle into a two-year timetable and changing the Congressional budget resolution into a joint resolution signed by the President. In addition, a number of lawmakers are concerned that the existing budget enforcement framework has made the budget process too complex and confusing; they seek changes that would make the process simpler, easier to understand, and more efficient. Concerns about long-term budgetary pressures may prompt proposals to restructure federal programs in ways that raise significant questions about the budget process, such as how the proposed changes should be treated and displayed in the federal budget. Those and other issues are important components of the more fundamental debate over surpluses that confronts lawmakers in the 107th Congress.